



# *Independent Trustee Services v Hope*: High Court rejects a cunning plan to protect pension scheme members

CAN TRUSTEES CONSIDER THE PENSION PROTECTION FUND WHEN MAKING DECISIONS?

EMPLOYMENT, PENSIONS AND BENEFITS BRIEFING 193

In *Independent Trustee Services v Hope* the UK High Court rejected a cunning plan to partially buy out benefits before the Ilford defined-benefit pension scheme entered the Pension Protection Fund's (PPF's) compensatory regime.

Although the facts of this case are unusual, the effect of the High Court's decision is that trustees may not be allowed to consider the existence of the PPF when making some decisions. This briefing explains.

In *Independent Trustee Services v Hope* [2009] EWHC 2810 (Ch), Henderson J, in the High Court, held that the trustees of the Ilford defined-benefit (DB) pension scheme could not seek to improve members' positions by buying out part of their benefits. The trustees were not allowed to take into account the potential protection of the Pension Protection Fund (PPF) when seeking to partially buy out benefits.

Broadly, the PPF can take over underfunded eligible DB pension schemes if the sponsoring employer has suffered a qualifying insolvency event. The PPF will then use the scheme's assets and its own assets (as a 'top-up') to compensate scheme members by providing benefits, but only up to a protected level. Generally, only members who have reached normal pension age (or retired early due to ill-health) will receive 100 per cent compensation – for further information see our briefing 117: [The Pensions Act 2004: PPF protected benefits](#)

## Facts of the case

In this case the scheme was significantly underfunded, the employer was insolvent and the trustees intended to take steps later to cause the scheme to enter the PPF. The trustees asked the court to rule on whether they could (in an extreme version of the proposal) use all the scheme's assets to buy out benefits for members who would have had a reduced and capped compensation. This would have secured higher benefits for these members than they would have received under PPF compensation. But the buy-out would leave no (or disproportionately reduced)

assets in the scheme to secure benefits for members who had not been bought out. In effect, the trustees were proposing this buy-out in the knowledge that once they had taken steps to transfer the scheme to the PPF, the PPF would need to use more of its own assets to protect members who had not been bought out. The buy-out would cause a net higher cost for the PPF.

## Decision

Henderson J held that the buy-out was unlawful for the following main reasons.

- The buy-out would use a share of the assets that did not 'fairly represent' the benefits of the members bought out. The buy-out would consume a disproportionate amount of the scheme's assets, which (if the PPF did not exist) would prejudice members who had not been bought out. For this to be allowed under the scheme rules it would 'need the clearest possible justification, and equally clear language'.
- The proposed buy-out was a 'blatant attempt to undermine or circumvent the policy of the PPF legislation' and was 'inimical to public interest'. This was because the proposal sought to 'minimise, if not eliminate, the Scheme assets which will vest in the PPF, at a time when the Scheme is seriously underfunded'. Furthermore, the proposal treated 'the availability of PPF compensation as though it were an advantage to be exploited for the Scheme's benefit, whereas Parliament clearly intended the PPF to be a funder of last resort which will step in if, and to the

extent that, the Scheme is unable to fund PPF level benefits with its own assets’.

- The trustees did *not* have to consider the PPF’s interest because it was not a contingent beneficiary of the scheme. But in light of the public interest argument it was a matter of law, in the context of the present case, that ‘the prospective availability of compensation under the PPF, if and when the Scheme enters the PPF, is not a relevant factor for the Trustee to take into account’ in the exercise of their discretionary powers and would not be relevant in ‘any instance where trustees seek to take advantage of the existence of the PPF as a justification for acting in a way which would otherwise be improper’.

## Comment

The facts of this case are unusual because the employer had become insolvent without triggering PPF protection and the trustees were the only creditors who had an interest in forcing a further insolvency event. This gave the trustees an unusual ability to control when the employer would suffer a ‘qualifying insolvency event’, without which the scheme could not enter the PPF. Therefore they had sufficient time to formulate a buy-out proposal before the qualifying insolvency event. Usually the employer itself or another contingent creditor would trigger the insolvency event, which would leave the trustees with insufficient time to formulate a buy-out. As the judge acknowledged, ‘typically, a period of between 15 and 24 months is needed’ for a buy-out.

Standing back, it seems reasonable (as the judge decided) to protect the PPF in the specific circumstances of this case. Having said that, Henderson J was obviously struggling to find a legal way of reaching his decision. The members pointed out that parliament has enacted a range of protections for the PPF but did not think it necessary to block this route.

The problem with the judgment is that it raises many uncertainties. Henderson J wanted to deter any future attempt to ‘take advantage of the existence of the PPF’ and held that there was a ‘principled basis upon which the court can intervene to nip behaviour of this kind in the bud’. So this decision could have wider relevance. For example, this case may prevent the trustees of a scheme that is funded below the PPF protected level from taking a ‘Las Vegas gamble’ by making high-risk investments

knowing that even if the investments fail, the scheme members will still be protected up to the PPF level.

If this case has wider application, Henderson J’s reliance on the ‘public interest’ arguments creates some uncertainty. It is not clear when this principle can be invoked in the future. For example, it may not always be clear when trustees are allowed to take the PPF into account when buying out benefits, allocating assets during a partial wind-up (eg if only some sections of the scheme are eligible for PPF entry), during a merger (trustees compare the PPF level before and after the merger), commuting pensions for cash or investing the scheme’s assets. But this decision will probably not affect buy-ins, because a buy-in policy will still be an asset of the scheme that is available to the PPF.

An odd aspect of this case is that the judge did not explain why a different approach was adopted by the Court of Appeal in the earlier case of *Easterly v Headway* [2009] (Henderson J didn’t even refer to this case). In *Easterly*, the Court of Appeal allowed a different cunning plan – ie for the trustees to carry out a partial buy-out that increased the employer’s liability to the scheme. Perhaps there may be less public interest in protecting an employer than in protecting the PPF? But it would have been better if this case had at least dealt with this.

In February 2010, the PPF commented that the representative beneficiaries in this case have since applied for permission to appeal Henderson J’s decision and that it is waiting for the outcome of that application. So, there may be still more to hear on this case.

In the meantime, the safest course of action for trustees is to ask themselves whether it would be reasonable for them to make a particular decision even if the PPF did not exist. Trustees should carefully minute these decisions so that they can later prove that the PPF’s existence was not a factor in their decision. If trustees cannot ignore the PPF’s existence, they will need advice based on the specific facts of their situation.

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